

having established its market power, to raise its price for long distance service. If SWBT were now to receive interLATA authorization in Arkansas and Missouri, where UNE- and facilities-based residential competition has yet to develop at all, the anticompetitive results for consumers of both local and long distance service would materialize much faster and be far worse.

A. InterLATA Authorization Is Not In The Public Interest Unless The BOC's Local Markets Are Irreversibly Open To Competition.

As a threshold matter, SWBT asserts that “the benefits of new entry long distance *presumptively* outweigh any risk of harm.” SWBT AR/MO Br. 145 (emphasis in original). In SWBT’s view, the Commission should presume that the public interest will be served by granting SWBT’s application, because (in SWBT’s view) such approval will spur competitors to enter the local market.

Any such presumption would conflict with the plain language of the statute, which puts the burden on the applicant to show that its entry would be “consistent with the public interest.” *See Michigan 271 Order* ¶ 43 (“Section 271 places on the applicant the burden of proving that all of the requirements for authorization to provide in-region, interLATA services are satisfied”). Indeed, the Commission has flatly rejected the argument that the public interest test can be satisfied by simply presuming that the benefits of additional entry into long distance will outweigh competitive harms arising from premature authorization:

As we have previously observed, ‘the entry of the BOC interLATA affiliates into the provision of interLATA services has the potential to increase price competition and lead to innovative new services and marketing efficiencies.’ Section 271, however, embodies a congressional determination that, in order for this potential to become a reality, local telecommunications markets must first be open to competition so that a BOC cannot use its control over bottleneck local exchange facilities to undermine competition in the long distance market. Only then is the other congressional intention of creating an incentive or reward for opening the local exchange market met.

Id. at 388.

The reason that SWBT is now attempting to revive a previously rejected presumption is clear. SWBT cannot possibly defend the benefits of premature long distance entry on the merits. Indeed, when a careful look is given to the state of local competition in Texas, the lesson for the public interest is clear: approving a section 271 application before local markets are open will not provoke successful local competition. If CLECs cannot profitably offer local residential service to customers, they cannot and will not effectively compete in the local market. As the Texas experience shows, that is true regardless of whether the incumbent has obtained long-distance authorization.

Accordingly, the key question to be resolved in the public interest inquiry is whether the BOC's local markets truly "are open to competition" from new entrants. *See, e.g., Kansas/Oklahoma 271 Order* ¶ 267. To be sure, the competitive checklist sets forth the minimum criteria that make it possible for local markets to be open to competition. But meeting the checklist requirements alone is not sufficient to demonstrate that local markets are open. Rather, Section 271(d)(3) requires an additional and independent finding that entry is in the public interest. *E.g., Michigan 271 Order* ¶ 389. The public interest test reflects Congress's realization that, at least in some states, mere satisfaction of the checklist would not be sufficient to allow local competition to develop, and that if the BOCs in those states nevertheless received long distance authority they would leverage their local monopoly into the long distance market – precisely the harm that the ban on interLATA service in Section 271(a) is designed to prevent.

The legislative history of Section 271 confirms that Congress intended the public interest determination to reflect an analysis of the actual competitive effects of granting the application. In describing the statutory role of DOJ, the Conference Report made clear that the

Department could make its analysis under any competitive standard it chose, including Section VIII(c) of the MFJ as well as statutory antitrust standards. S. Conf. Rep. No. 104-230, at 149 (1996). See *Michigan 271 Order* ¶ 383 (exploring relevance of DOJ Evaluation to considerations of public interest). Thus, as the Commission has previously stated, Section 271 “embodies a congressional determination that . . . local telecommunications markets must *first* be open to competition so that a BOC cannot use its control over bottleneck local exchange facilities to undermine competition in the long distance market.” *Michigan 271 Order* ¶ 388 (emphasis added).

Thus, to determine whether the BOC’s local telecommunications markets are in fact open to competition, the Commission first reviews the extent to which new entrants “are actually offering” local service to both business and residential customers through each of the three means offered by the Act. *Michigan 271 Order* ¶ 391. Second, where local competition is not securely established, the Commission determines whether this reflects the continuing presence of entry barriers and BOC misconduct, or is attributable instead solely to the business decisions of potential new entrants.

B. SWBT Maintains Monopoly Power Over Residential Service.

In its *Michigan 271 Order*, the Commission recognized both that the “Act contemplates three paths of entry into the local market – the construction of new networks, the use of unbundled elements of the incumbent’s network, and resale,” (*id.* ¶ 96), and that Congress “sought to ensure that all procompetitive entry strategies are available.” *Id.* ¶ 387. The Commission concluded that “[o]ur public interest analysis of a section 271 application, consequently, *must* include an assessment of whether all procompetitive entry strategies are available to new entrants.” *Id.* (emphasis added). The Commission then explained that “[t]he most probative evidence that all entry strategies are available would be that new entrants *are*

actually offering competitive local telecommunications services to different classes of customers (residential and business) through a variety of arrangements (that is, through resale, unbundled elements, interconnection with the incumbent's network, or some combination thereof) in different geographic regions (urban, suburban, and rural) in the relevant state, and at different scales of operation (small and large)." *Id.* at ¶ 391 (emphasis added). In subsequent applications, the Commission has repeatedly considered the degree to which competitors have actually succeeded in offering local telecommunications services using the different entry strategies prescribed by the Act. *See New York 271 Order* ¶¶ 13-14; *Texas 271 Order* ¶¶ 5-6.

Here, SWBT's own data confirm that competitors have not yet been able significantly and irreversibly to enter the local residential market. In particular, those data show that SWBT maintains a virtual monopoly over residential service in its Arkansas and Missouri service territories. Using the E911 data presented by SWBT witnesses J. Gary Smith (for Arkansas) and David R. Tebeau (for Missouri), Tables 1, 2, 3 and 4 show the amount of CLEC competition in Arkansas and Missouri. The data in Table 2 show that there is insignificant competition for residential service in Arkansas -- less than 1% of the residential lines in SWBT's Arkansas service territory are served by facilities-based competitors and less than 1% of such lines are served by UNE-based competitors. Table 4 shows that there is similarly *de minimis* competition for residential service in Missouri -- less than 2% of the residential lines in SWBT's Missouri service territory are served by facilities-based and only 1/10 of 1% of such lines are served by UNE-based competitors.

TABLE 1: Total CLEC Penetration in SWBT's Arkansas Service Territory

	Quantity	Share
SWBT Retail Switched Access Lines (G. Smith Aff., Table 6)	1,030,078	91.38%
CLEC Facilities-Based Lines (G. Smith Aff. at 18)	57,517	5.10%
CLEC UNE Lines (G. Smith Aff. at 18)	5,575	0.49%
CLEC Resale Lines (G. Smith Aff., Table 7)	34,138	3.03%
Total Lines in SWBT Arkansas Service Territory	1,127,308	100.0%

TABLE 2: Residential Market CLEC Penetration in SWBT's Arkansas Service Territory

	Quantity	Share
SWBT Arkansas Retail Residential Switched Access Lines (G. Smith Aff. Table 6)	659,125	94.34%
CLEC Residential Facilities-Based Lines (G. Smith Aff. Table 3)	5,250	0.75%
CLEC Residential UNE Lines (G. Smith Aff. Table 3)	3,724	0.53%
CLEC Residential Resale Lines (G. Smith Aff. Table 7)	30,550	4.37%
Total Residential Lines in SWBT Arkansas Service Territory	698,649	100.0%

TABLE 3: Total CLEC Penetration in SWBT's Missouri Service Territory

	Quantity	Share
SWBT Retail Switched Access Lines (Tebeau Aff. Table 6)	2,588,567	89.75%
CLEC Facilities-Based Lines (Tebeau Aff. Table 18)	143,444	4.97%
CLEC UNE Lines (Tebeau Aff. Table 18)	58,093	2.01%
CLEC Resale Lines (Tebeau Aff. Table 7)	94,096	3.26%
Total Lines in SWBT Missouri Service Territory	2,884,200	100.0%

TABLE 4: Residential Market CLEC Penetration in SWBT's Missouri Service Territory

	Quantity	Share
SWBT Arkansas Retail Residential Switched Access Lines (Tebeau Aff. Table 6)	1,743,246	96.44%
CLEC Residential Facilities-Based Lines (Tebeau Aff. Table 3)	28,019	1.55%
CLEC Residential UNE Lines (Tebeau Aff. Table 3)	1,833	0.10%
CLEC Residential Resale Lines (Tebeau Aff. Table 7)	34,468	1.91%
Total Residential Lines in SWBT Missouri Service Territory	1,807,566	100.0%

Thus, the data in Tables 2 and 4 shows that there is, at most, *de minimis* facilities-based competition for residential service – just 0.75% of the residential lines in SWBT's Arkansas service territory and only 1.55% in its Missouri territory.

In addition, as reflected in Tables 5 and 6 (below), many of the facilities-based CLECs that SWBT identifies as its competitors in Arkansas and Missouri,¹²⁶ have gone, or are going, out of business or are otherwise in financial distress at the present time. Indeed, SWBT's own evidence indicates that facilities-based entry by CLECs in both Arkansas and Missouri

¹²⁶ Smith Aff. Attachment E (Arkansas); Tebeau Aff. Attachment E (Missouri).

reached a plateau in the first half of 2001.¹²⁷ As reflected in Attachment 2, over a dozen CLECs in Missouri have surrendered their certificates of public convenience and necessity just in the last year. Moreover, a recent study indicates that CLEC market shares nationally are beginning to *decrease* (from 8.5% to 7.6%) due to CLECs' financial difficulties.¹²⁸ The anemic financial condition of the CLECs will hamper their ability to make the investments necessary to bring facilities-based competition to Arkansas or Missouri.

TABLE 5: THE CURRENT FINANCIAL STATUS OF FACILITIES-BASED ARKANSAS CLECs IDENTIFIED BY SWBT¹²⁹

<u>Facilities-Based Provider (AR)</u>	<u>Change in Mkt. Cap.</u>	<u>Current Financial Situation</u>
Alltel Communications	- 15.71%	2 nd Quarter 2001 profits declined 4%; 1 st Quarter 2001 earnings fell by over \$20 million; announced in February 2001 plans to lay off 1,000 employees and reduce number of operating regions from five to three. Withdrew from residential market in Arkansas.
Logix Communications		Reported 2 nd Quarter 2001 revenue decrease of 7.2%, year 2000 revenue decrease of 4.6%, and year 1999 loss of \$37.7.
McLeod USA	- 94.55%	Reported 2 nd Quarter 2001 net loss of \$131.7 million, lowered its revenue cash-flow targets for 2001 and 2002; announced in May 2001 elimination of 600 jobs (5% of workforce) and cut 2001-2002 capital expenditure plan by \$300 million, curbing ability to expand; reported 1 st Quarter 2001 loss of \$187 million.
Navigator Telecommunications		Told Arkansas Public Service Commission would not take new orders for residential service, citing its operational and pricing issues with Southwestern Bell.
WorldCom Technologies	- 61.60%	Announced in August 2001 cut in capital spending by \$2 billion for 2002; reported in July 2001 decreased net income of 85%, earnings decrease of 26%, revenue decrease of 4.6%, and lowered outlook for full year, while MCI Group reported net loss of \$29 million and revenue decrease of 15%; laid off 6,300 employees (6-7% of workforce) in February 2001, 361 in March 2001, and 832 in April 2001.
DSL.net	- 95.15%	Applied to FCC in July 2001 to discontinue interstate special access DSL service for high-speed Internet access in 22 states; reported 2 nd Quarter 2001 net loss of \$23.6 million, and 1 st Quarter net loss of \$25.7 million; Stephens Inc. dropped coverage in August 2001 because it believes DSL.net will run out of cash in next few months and be forced to file for bankruptcy; announced in July 2001 that elimination of 90 jobs and closing 250 operational central offices, and expects to record a loss of \$80 to \$90 million in 2001; 1 st Quarter 2001 net loss widened to \$26.6 million, from \$18.3 million in 4 th Quarter 2000; reported 4 th Quarter 2000 loss of just under \$30 million.
Covad	- 97.28%	Filed for Chapter 11 Bankruptcy in August 2001 designed to eliminate \$1.4 billion in debt; shut down and dissolved BlueStar Communications Group network operations in June 2001 and Nasdaq has contacted regarding possible delisting; bondholders pressing management to halt spending, reported 2001 1 st Quarter net

¹²⁷ See G. Smith Aff. Chart 1 (Arkansas); Tebeau Aff. Chart 1 (Missouri).

¹²⁸ Legg Mason Equity Research, *Telephone wars: Local Competition Update* (May 22, 2001).

¹²⁹ Table 5 is derived from Attachment 3 hereto.

		loss of \$199 million, laid off 1,200 employees in recent months, and closed 350 local equipment hubs.
New Edge Networks		Since February 2001 has scaled back service (shifted focus away from DSL to wide-area networks and virtual private networking, as well as retreated from markets in Georgia and Florida) and expansion plans (installed equipment in half the number of central offices nationwide as originally intended), altered business plan because could not secure additional money to pay for expensive start-up/expansion, and laid off 40% of workforce since November 2000.

TABLE 6: THE CURRENT FINANCIAL STATUS OF FACILITIES-BASED MISSOURI CLECs IDENTIFIED BY SWBT¹³⁰

<u>Facilities-Based Provider (MO)</u>	<u>Change in Mkt. Cap.</u>	<u>Current Financial Situation</u>
AT&T	- 22.53%	Posted overall loss of \$191 million for 2 nd Quarter 2001, following net loss of \$373 million for 1 st Quarter; expects a significant decline in revenue from consumer long-distance customers (15% decrease for first-quarter 2001); announced in August 2001 closing San Antonio office (590 employees); has written off more than \$3 billion on its Excite@Home investment.
AT&T Broadband		Comcast offered to purchase for \$44 billion in July 2001; 1 st Quarter 2001 operating cash flow fell by 22% and cash-flow margins dropped to 16%; laid off 4,500 employees in 2001, including 1,200 in the 2 nd Quarter, 130 in July, 233 in June, and 309 in January.
Birch Telecom		Withdrew initial public offering in May 2001 due to poor market conditions; reported 1 st Quarter 2001 net losses of \$46.9 million; laid off 306 employees on February 23, 2001, and 138 on November 13, 2000 (combined, about 28% of its workforce).
Global Crossing	- 90.70%	U.S. Department of Defense canceled \$400 million contract with company in August 2001; rumors persist of impending bankruptcy; reported 2 nd Quarter 2001 loss of \$629.6 million, reduced growth and revenue outlook for year, eliminating 2,000 jobs (15% of workforce), will close 100 facilities worldwide, and lost \$516 million in year 2000.
Intermedia Communications		Acquired and will be absorbed by WorldCom, which in August 2001 agreed to sell Intermedia's Internet services; reported 1 st Quarter 2001 net loss of \$224.1.
McLeod USA	- 94.55%	Reported 2 nd Quarter 2001 net loss of \$131.7 million, lowered its revenue cash-flow targets for 2001 and 2002; announced in May 2001 elimination of 600 jobs (5% of workforce) and cut 2001-2002 capital expenditure plan by \$300 million, curbing ability to expand; reported 1 st Quarter 2001 loss of \$187 million.
Omniplex Communications		Filed for Chapter 11 bankruptcy in March 2001.
Sprint	- 38.15%	2 nd Quarter 2001 net income declined 21% because of rising costs and lackluster sales of long-distance service, and revenue slipped 3.1%.
Sprint PCS	- 53.44%	Reported 2 nd Quarter 2001 loss of \$247 million.
Talk America Holdings (formerly Talk.com)	- 93.65%	California Public Utilities Commission investigating allegedly deceptive telemarketing practices ("slamming" and "cramming"); reported 2 nd Quarter 2001 loss of \$62.7 million, total revenue drop of \$133.7 million, and lost \$72.8 million for first six months of 2001; reported 1 st Quarter 2001 loss of \$10.7 million and revenue drop of \$137.8 million.
WorldCom Technologies	- 61.60%	Announced in August 2001 cut in capital spending by \$2 billion for 2002; reported in July 2001 decreased net income of 85%, earnings decrease of 26%, revenue decrease of 4.6%, and lowered outlook for full year, while MCI Group reported net loss of \$29 million and revenue decrease of 15%; laid off 6,300 employees (6-7% of workforce) in February 2001, 361 in March 2001, and 832 in April 2001.
DSL.net	- 95.15%	Applied to FCC in July 2001 to discontinue interstate special access DSL service for high-speed Internet access in 22 states; reported 2 nd Quarter 2001 net loss of \$23.6 million, and 1 st Quarter net loss of \$25.7 million; Stephens Inc. dropped coverage in August 2001 because it believes DSL.net will run out of cash in next few months and be

¹³⁰ Table 6 is derived from Attachment 4 hereto.

		forced to file for bankruptcy; announced in July 2001 that elimination of 90 jobs and closing 250 operational central offices, and expects to record a loss of \$80 to \$90 million in 2001; 1 st Quarter 2001 net loss widened to \$26.6 million, from \$18.3 million in 4 th Quarter 2000; reported 4 th Quarter 2000 loss of just under \$30 million.
Covad	- 97.28%	Filed for Chapter 11 Bankruptcy in August 2001 designed to eliminate \$1.4 billion in debt; shut down and dissolved BlueStar Communications Group network operations in June 2001 and Nasdaq has contacted regarding possible delisting; bondholders pressing management to halt spending, reported 2001 1 st Quarter net loss of \$199 million, laid off 1,200 employees in recent months, and closed 350 local equipment hubs.
New Edge Networks		Since February 2001 has scaled back service (shifted focus away from DSL to wide-area networks and virtual private networking, as well as retreated from markets in Georgia and Florida) and expansion plans (installed equipment in half the number of central offices nationwide as originally intended), altered business plan because could not secure additional money to pay for expensive start-up/expansion, and laid off 40% of workforce since November 2000.

The prospects for increased UNE-based competition are also bleak. The microscopic level of UNE-platform-based entry in Arkansas and Missouri is significantly smaller than the level achieved in other states. As reflected in Table 7, the current level of UNE-based competition for residential service in SWBT's Arkansas and Missouri service territory is about 1-3% of the levels of UNE-based residential competition that existed in New York and Texas at the time the Commission considered § 271 applications for those states.

TABLE 7: COMPARISON OF UNE-BASED RESIDENTIAL SERVICE LEVELS IN MISSOURI, NEW YORK AND TEXAS (number of UNE-based residential lines)

	ARKANSAS	MISSOURI	NEW YORK	TEXAS
LINES AT TIME OF 271 APPLICATION	3,724 ¹³¹	1,833 ¹³²	137,342 ¹³³	236,000 ¹³⁴

Finally, resale, which represents the bulk of the residential “competition” in Arkansas and Missouri, is an inherently limited competitive vehicle, because resale-based

¹³¹ G. Smith Aff. Table 3

¹³² Tebeau Aff. Table 3.

¹³³ New York 271 Order ¶14.

¹³⁴ Based on information contained in the Supplemental Affidavit of SWBT witness John S. Habeeb filed in CC Docket No. 00-4 on April 5, 2000, CLECs in Texas provided UNE-P based service to 119,871 residential customers and 83,301 business customers as of February 2000. Supplemental Declaration of A. Daniel Kelley and Steven E. Turner on Behalf of AT&T Corp., Table 2, filed in FCC CC Docket No. 00-65 on April 26, 2000. Accordingly, based on SWBT's own data, about 59% of the UNE-P service in its Texas service territory was provided to residential customers as of February 2000. SWBT reports that, as of the time of the Commission's June 30, 2000 *Texas 271 Order*, there were 472,249 UNE-P customers in Texas. See SBC Public Affairs Report accessed on April 23, 2001 on SBC's web-site at www.sbc.com/Long-Distance/0,2951,7,00.html. Assuming, about half of these lines served residential customers, yields a total of about 236,000 residential UNE-P customers.

competitors cannot alter the nature of the service they are reselling, and thus cannot provide consumers with innovative or improved service. And in any case, resale is priced in a manner that precludes its use in all but the most selectively chosen circumstances.¹³⁵

C. SWBT's Local Residential Markets Remain Closed To UNE- and Facilities-Based Competition Due To Entry Barriers And SWBT's Own Actions.

The absence of meaningful local competition does not end the public interest inquiry. As the Commission has repeatedly made clear, it will “not construe the 1996 Act to require that a BOC lose a specific percentage of its market share.” *Michigan 271 Order* ¶ 391; *see, e.g., Kansas/Oklahoma 271 Order* ¶ 215. Thus, although the level of market penetration that CLECs have attained is relevant to whether the BOC's historic monopoly has been broken, it is not dispositive. Rather, where data indicate that a BOC is not facing local competition, the Commission's “inquiry then would necessarily focus on whether the lack of competitive entry is due to the BOC's failure to cooperate in opening its network to competitors, the existence of barriers to entry, the business decisions of potential entrants, or some other reason.” *Michigan 271 Order* ¶ 391. To make this determination, the Commission should consider all “relevant factors” that might “frustrate congressional intent that markets be open [to competition].” *Kansas/Oklahoma 271 Order* at ¶ 267.

A review of the evidence makes clear that entry barriers and SWBT's own actions have perpetuated SWBT's monopoly over residential service in Arkansas and Missouri. The evidence confirm the presence of several important barriers to entry into the local residential market in Arkansas and Missouri.

¹³⁵ The avoided cost discount has proved inadequate to provide CLECs a basis for profitable entry for most consumers. For example, as monopolists, the incumbents do not face (and therefore do not “avoid”) the huge customer acquisition costs that CLECs confront, nor do they face the lack of economies of scale that a new entrant must address. And CLECs providing resale do not benefit from access revenue. For all of these reasons, CLECs
(continued)

1. First, SWBT's Missouri UNE rates and its rates for non-recurring UNEs in Arkansas are not remotely TELRIC compliant.¹³⁶ Nevertheless, even if the Commission were to conclude that its TELRIC pricing methodology was elastic enough to accommodate these Missouri and Arkansas UNE rates, pricing disparities of the type and magnitude present in these states simply cannot be ignored. Even relatively small deviations from true forward-looking cost-based prices foreclose widespread competition. *See* Clarke Decl. ¶¶ 5-26 (attached Baranowski AR/MO Decl.).

For example, AT&T's margin analysis confirms that, at current prices, residential UNE-based competition is not viable in Missouri. In two of the four Missouri UNE rate zones, a new competitor would lose money on each residential line it serves, *even if its internal costs of running its business are excluded*. *See* Lieberman AR/MO Decl. ¶¶ 18-20. Even in the other two zones, the margins – while positive with respect to the cost of UNEs alone – are too thin to cover the essential and unavoidable internal retailing costs (*e.g.*, for marketing, customer service, billing, order processing and other operating activities, all of which any competitor must bear if it is to use the incumbent's UNEs to provide a telecommunications service. *See id.* The fact that local entry is unprofitable anywhere in Missouri at prevailing UNE rates is, on its face, precisely the sort of "relevant factor" that "would frustrate the congressional intent that markets be open" before interLATA entry is approved, *New York 271 Order* ¶ 423, particularly since it is obvious

seeking to provide a broad-based, significant competitive alternative to the incumbents' local residential monopoly cannot do so through the resale of local service.

¹³⁶ As discussed above, a finding of checklist compliance is not dispositive of the public interest. For example, with respect to UNE prices, the fact that UNE prices have been set within the "range" that the Commission has held to be acceptable for determining that UNE rates are cost-based does not answer the question whether UNE rates are sufficiently low to permit substantial and irreversible UNE-based competition. The Commission could, consistent with the Act, require a BOC applicant and a state to choose between setting UNE rates at the "lower" end of the TELRIC range, changing retail price caps or subsidies, or otherwise taking steps to ensure that efficient CLECs have a meaningful opportunity to use UNEs to compete with the incumbent.

that local entry “is vitally dependent on appropriate pricing” of UNEs. *Michigan 271 Order* ¶ 281.

2. Second, the *uncertainty* concerning the permanent level of UNE rates creates an additional barrier to entry. For a potential entrant to determine whether entry in a local market is worth the substantial up-front investment, and given the importance of even small differences cost differences, an entrant must have some degree of certainty as to the cost of its crucial inputs. Uncertainty in UNE-rates – the largest single input to the cost of local entry – severely compromises the ability of a CLEC to execute a business plan. Competitive entry in Missouri has been plagued by precisely this sort of uncertainty. The APSC has similarly noted that uncertainty about SWBT’s UNE prices – and whether the APSC even had the authority to set such prices – were the key factors in the withdrawal from the residential market of ALLTEL, the only facilities-based provider of residential services in Arkansas at the time.¹³⁷ The uncertainty about SWBT’s UNE pricing is aggravated by the fact that SWBT challenged many of the key UNE rates and ultimately obtained an order from the United States Court of Appeals for the Eighth Circuit declaring them to be unlawful, because they were based on the Commission’s TELRIC pricing rules.¹³⁸ Although that order has now been stayed, pending review by the United States Supreme Court, SWBT’s refusal to accept its basic obligation under the Act to provide access to UNEs at cost-based rates has created tremendous uncertainty over the future price of UNE inputs which are crucial to any plan for broad-based residential entry.

3. A third significant entry barrier is the absence both of accurate performance reporting and of an effective enforcement plan. The Commission has consistently

¹³⁷ *Consultation Report* at 5, 10-11.

¹³⁸ *Southwestern Bell Tel. Co. v. Missouri Pub. Serv. Comm’n*, 236 F.3d 922 (8th Cir. 2001), *stay granted* No. 99-3833 (8th Cir. Feb. 7, 2001).

held that a critical public-interest consideration is whether the BOC has established reliable performance measures and effective enforcement mechanisms to ensure that local markets *remain* open to competition after section 271 relief is granted. *E.g., Michigan 271 Order* ¶¶ 393-94. Such measures are crucial to the ability and willingness of new entrants to incur the substantial investment required to enter a BOC's local market, as well as to the continuing viability of competition once entry has occurred. UNE-based competitors, in particular, virtually depend on the cooperation of the BOC for their success. A reliable and enforceable set of performance standards is therefore a critical indicator of whether new entrants will be able "to obtain necessary inputs from the incumbent" to which they are legally entitled "without resort to lengthy regulatory or judicial intervention" or "protracted and contentious legal proceedings" (*id.* ¶ 394) – all of which serve to increase costs and uncertainty and therefore to deter and defeat competitive entry.

The problems with SWBT's existing performance measures and enforcement plan are exacerbated by the APSC's admittedly "limited legal authority to ensure future performance."¹³⁹ CLECs' concerns are not idle, as SWBT has admitted submitting false affidavits concerning loop qualification in support of its Kansas and Oklahoma 271 applications. SWBT's letter to the Commission, dated April 13, 2001, admits that SWBT repeatedly submitted materially false testimony to the Commission in order to rebut a competitor's charge that SWBT was in violation of Commission orders and the section 271 competitive checklist. The Commission explicitly relied upon SWBT's misrepresentations in finding that SWBT complied with the checklist and was entitled to section 271 authorization.¹⁴⁰ SWBT's conduct in

¹³⁹ *Second Consultation Report* at 12.

¹⁴⁰ The Arkansas Public Service Commission is currently conducting an investigation into SWBT's misrepresentations. *See* Order No. 16, Docket No. 00-211-U (May 7, 2001). This episode is not the first time SBC has been investigated for submitting false information. *See In re SBC Communications Inc.*, FCC 99-153 (rel. June (continued))

connection with the Kansas/Oklahoma application underscores its willingness to say – but not do – what is needed to gain section 271 authorization.¹⁴¹

SWBT has also shown that it is content to pay millions of dollars in penalties each month for the privilege of continuing to block local entry rather than eliminating deficient performance blocking such entry. Accordingly, this Commission cannot reasonably rely upon SWBT's assertion that the threat of penalties for non-compliance with performance measure obligations will prevent “backsliding” into further discrimination in the future. *See* SWBT AR/MO Br. at 159-156, 161. According to a recent analyst report,¹⁴² SWBT has already paid \$23 million in penalties to date, and \$4.6 million as recently as March 2001, for its failure to comply with performance obligations agreed to as part of the merger with Ameritech. According

28, 1999) (“SBC/SNET Consent Decree”). In the SBC/SNET Consent Decree, the Commission found that statements allegedly made by SBC to the FCC were not accurate, and an SBC legal review team acknowledged violations of the Telecommunications Act, as well as “compliance problems and mistakes.” *Id.* ¶¶ 5, 10. *See also* *Petition of Accelerated Connections, Inc., d/b/a/ACI Corp For Arbitration to Establish an Interconnection Agreement With SWBT*, TPUC Docket No. 20226, Order on Appeal of Order No. 20 (Oct. 13, 1999) (affirming over \$800,000 in sanctions against SWBT for failure to produce information and documents in discovery).

¹⁴¹ Indeed, SWBT, aware of false statements in materials provided to the Commission in February 2001, failed to report these false statements to the Commission until April 2001. *SWBT's Response to the Commission's Order of May 7, 2001*, Docket No. 00-211-U, at 10-11 (April 2001). This pattern of SWBT misconduct was repeated again recently. On April 4, 2001, SWBT filed its initial Section 271 application for Missouri with the Commission (subsequently withdrawn), including numerous representations concerning the non-discriminatory performance of its OSS. Simultaneously with the filing of that application, at a workshop on performance measures conducted by the TPUC in April 2001, SWBT stated that in calculating the flow-through rates for CLEC orders, it has always excluded from the denominator all UNE-P orders that, although not designed to flow through SWBT's systems without manual intervention when submitted by a CLEC, would have flowed through SBC's systems if the same order type had been submitted by SBC's retail operations. Willard/Vane Water Decl. ¶¶ 47 (citing, *inter alia*, Willard MO 271 Decl. ¶ 37). This methodology is totally contrary to the language of the applicable business rules, and to the interpretation of these rules by the TPUC Staff. As a result of SWBT's exclusion of UNE-P “orders that would flow through EASE” from the denominator, the reported flow-through rates for CLEC orders submitted via the EDI and LEX interfaces are *overstated* – making SWBT's performance appear better than if had calculated the rates according to the business rules. *Id.* ¶¶ 47. In addition, evidence presented at the TPUC workshop suggests that SWBT may also have *understated* the flow-through rate for its own retail operations, by improperly including in the denominator retail order types that are not designed to flow through its proprietary EASE interface. *Id.* SWBT's revelation of its erroneous methodology sent the TPUC Staff “reeling, from the realization that the data collected under [Performance Measure] 13 wasn't what we thought it was.” Willard MO Decl. ¶ 38 & Att. 3 at 220-221. The TPUC has ordered an audit of SWBT's reported Texas flow-through data (Texas performance data affected by updating problems in LMOS). *Id.* ¶¶ 39, 50.

to SBC's website for CLECs, SWBT has already paid more than \$8 million in penalties for its 5-State SWBT region, including more than \$7.4 million in Texas, where SWBT has already received Section 271 approval.¹⁴³ Moreover, the recent analyst report notes that the amount of fines levied against SWBT understate the level of non-compliance, because the plans "cap" certain fines and thus preclude any levy of additional fines for below-standard performance.¹⁴⁴ Because SWBT evidently views the prospect of paying fines for non-compliance with performance measure obligations as a mere cost-of-doing business, the Commission may not reasonably rely on the presence of a performance compliance plan as a substitute for demonstrated full implementation of SWBT's duty to provide nondiscriminatory access to OSS.

4. Fourth, the record confirms that SWBT has failed "to cooperate in opening its network to competitors" and has engaged in "discriminatory or other anticompetitive conduct." *Michigan 271 Order* ¶¶ 391, 397. Such conduct has been particularly pronounced for advanced services, as discussed in Part III, *supra*. SWBT's misconduct has also been harmful with respect to competitive facilities-based residential service which, like UNE-based service, remains de minimis in Missouri. DOJ MO Eval. at 4-5.

For example, until ordered to do so by the MPSC, SWBT improperly refused to recognize CLECs as participants in Missouri's Metropolitan Calling Area Plan ("MCA") by programming its switches to screen the NXX codes of facilities-based CLEC MCA

¹⁴² See Merrill Lynch Global Securities Research, "Telecommunications/Services – Local," Hoexter's Broadband Bits, Issue No. 62 (April 13, 2001).

¹⁴³ In December 2000 alone, according to SBC's website for CLECs, SBC paid more than \$1.6 million in penalties for Texas. See <https://clec.sbc.com>. Indeed, the monthly penalties that SBC has paid for Texas have been considerably higher than the amount (approximately \$213,000) that it paid for June 2000 (the month when SWBT Texas application was approved). Since July, the monthly penalties paid by SWBT for Texas have ranged from \$289,150 in July to \$1,619,050 for December. In Kansas, SWBT paid more than \$167,000 in penalties in February – the first full month following the Commission's approval of SWBT's 271 application for that State.

¹⁴⁴ Merrill Lynch Global Securities Research, *supra*.

subscribers.¹⁴⁵ As a result, CLEC customers had a smaller inbound calling scope than comparable SWBT customers. Thus, anyone calling those CLECs' customers were required to dial extra digits and pay toll charges. This anticompetitive behavior was directly targeted at facilities-based providers – CLECs that relied on resale were able to participate in the MCA plan. As AT&T showed in connection with a complaint in filed in Missouri on this issue, this significantly impaired the ability of it and other facilities-based carriers to attract and retain customers, one of whom testified that he felt his business was “punish[ed] for changing phone companies.” Kohly Testimony at 45. SWBT was not required to alter its policy until after it filed its renewed 271 application, a year after AT&T's complaint was filed.

In yet another example of misconduct, for a significant period of time last year, SWBT improperly used a “winback” unit – a unit whose mission was to retain customers for SWBT – to administer local PIC freezes placed on its customers' accounts. Not surprisingly given this arrangement, in many instances, SWBT refused to remove the freeze after the customer contacted SWBT, and even refused to participate in third-party conferencing with the customer and AT&T representative to resolve the problem. Kohly Testimony at 30-34. Obviously, the failure to remove the PIC freeze upon request increases the likelihood that the customer will not change providers, especially where it is SWBT's winback unit that has the contact with, and therefore the opportunity to dissuade, the customer from switching providers.

In sum, the lack of CLEC competition for residential service is due to SWBT's “failure to cooperate in opening its network to competitors” and to the “existence of barriers to entry.” *Michigan 271 Order* ¶ 391. At the same time, the record also confirms that the lack of

¹⁴⁵ DOJ MO Eval. at 6 & n.21; see also Direct Testimony of R. Matthew Kohly on Behalf of AT&T Communications of the Southwest, Inc., *Application of SWBT to Provide Notice of Intent to File an Application for Authorization to Provide In-Region InterLATA Services Originating In Missouri Pursuant to Section 271 of the* (continued)

competitive entry in Arkansas and Missouri is *not* due to “the business decisions of potential entrants” that are independent of the entry barriers and BOC misconduct described above. Nothing in the record suggests that potential entrants have decided that the Missouri market, though open, is simply not worth pursuing. To the contrary, the record shows that potential entrants have not entered the residential market in Arkansas and Missouri because (1) entry is unprofitable at prevailing UNE rates; (2) the MPSC has not demonstrated a commitment to establish permanent cost-based rates; (3) SWBT is vigorously and successfully litigating over its very obligation to provide cost-based rates; (4) SWBT will misrepresent facts to support premature 271 authority, including inaccurately reporting to state and federal regulators that its performance is non-discriminatory; (5) SWBT will pay millions of dollars in penalties each month for the privilege of continuing to block local entry rather than eliminating the deficient performance; and (6) SWBT continues to obstruct entry through discriminatory and non-cooperative conduct.

Thus, although low-to-nonexistent market shares are not necessarily inconsistent with a finding that markets are irreversibly open to local competition, that is true only if other factors are present that “demonstrate that competitive alternatives can flourish rapidly throughout a state.” *Michigan 271 Order* ¶ 392. Where, as here, the lack of entry reflects BOC misconduct and persistent entry barriers, then the Commission must conclude that the local markets are not open to competition and interLATA authorization is not in the public interest.

Telecommunications Act of 1996, Missouri PSC TO-99-227 (Aug. 28, 2000) (“Kohly Testimony” appended hereto as Attachment 1), at 34-49.

D. The TPUC Local Competition Report Confirms Congress' Judgment That Approving A Section 271 Application Before Local Markets Are Open Will Not Produce Successful Local Competition.

The rosy picture that SWBT paints of flourishing local competition in Texas stands in stark contrast to the January 2001 *TPUC Report* (Att. 1), which reveals that:

- “monopoly power exists . . . in residential and rural markets in Texas” (*id.* at 83; *see* xiii);
- severe financial problems have caused both large and small CLECs to reduce or eliminate their residential service in Texas (*id.* at 55-58, 80-81);
- this lack of competition has permitted SWBT to extend its monopoly into the provision of bundled combinations of local and long distance services, and to *raise* its prices for local services to both residential and business customers (*id.* at x, 62-64, 79, 81);¹⁴⁶ and, given this monopoly power,
- “residential and rural customers are better served by existing price cap regulation of traditional nonbasic local service until more viable and sustainable competitive choices become available to them.”¹⁴⁷

Although SWBT trumpets the alleged competition currently being provided by, in particular, AT&T, WorldCom and Sprint (SWBT AR/MO Br. at 151), the *TPUC Report* describes in detail how all three companies have recently have *reduced* their presence in residential voice markets in Texas and de-emphasized local exchange service in the State. *TPUC Report* at 58-61. The *TPUC Report* also describes in detail how market recognition of the continuing barriers to profitable CLEC service have caused many of those competitors to reduce or eliminate their residential service in Texas. *Id.* at 56-57 (“four CLECs that once had a capitalization . . . [of] \$800 million or more in 1998 or 1999 – Covad, ICG, Rhythms, and Teligent – saw their share prices fall more than 95 percent from their 2000 peaks. In contrast, the stock price of the leading ILEC in Texas, Southwestern Bell, was less than 10 percent off its peak in 2000”).

¹⁴⁶ As described below, SWBT has also recently raised its rates for long distance service.

¹⁴⁷ *Id.* at ix.

Contrary to SWBT's claims of falling prices, the TPUC describes how declining CLEC competition has permitted SWBT to *raise* its prices for local services:

SWBT has significantly increased the prices for a number of nonbasic services, often services that are very popular and for which competitive alternatives are very limited. In September of 1999, SWBT raised prices on some of its more popular business call-management services in a range of approximately 6% to 42%. In November of 1999, SWBT increased the price of a business extra directory listing by 107% from \$1.45 to \$3.00. In June of 2000, SWBT increased its monthly rates for residential Caller ID services (caller ID name-or-number and caller ID name-and-number, both of which are very popular in Texas) in a range of 22% to 30%. SWBT also raised the following rates: (1) for per-use three-way calling, from \$.75 to \$.95, with the \$6.00 monthly cap eliminated; (2) for call return, from \$.50 to \$.95 per use, while eliminating the \$4.00 monthly cap; and (3) for residential call blocker and residential auto redial, from \$2.00 to \$3.00 each per month. In late 2000, SWBT raised its analog private-line rates by an average of 15%.

Id. at 62-63; *see also id.* at 79.¹⁴⁸

Finally, while SWBT repeatedly boasts about the numbers of long distance customers it has added in Texas, the *TPUC Report* makes clear that this phenomenon reflects the fact SWBT has begun to extend its monopoly in the provision of residential services into the provision of "bundled" combinations of local and long distance services:

Because Southwestern Bell can now compete for long distance customers in Texas, the company has made a strong push in 2000 to bundle its offerings to provide residential customers with various options for 'one-stop shopping.' . . . Southwestern Bell also gained a sizeable portion of the long distance market just months after offering long distance service for the first time. Southwestern Bell's largest and strongest competitors have not been offering substantial competition in vertical services or in bundling local residential services with long distance or other services and have lost market share in long distance service.

¹⁴⁸ The declining competition from CLECs in Texas and elsewhere has also permitted ILECs to slow down their roll-outs of DSL services. "CLEC Aftermath: Will DSL Become Another BOC Monopoly As Competitive Carriers Die Out," *America's Network*, at 34 (April 1, 2001).

Id. at x.¹⁴⁹ Thus, the TPUC found that “by the end of 2000, SWBT’s financial position had strengthened relative to the CLECs.” *Id.* at 81. Of crucial importance here, the TPUC found that “SWBT’s entry into the long distance market has weakened the ability of CLECs to challenge SWBT in local voice service,” and allowed SWBT to raise prices. *Id.*

Indeed, as if to provide further confirmation of the TPUC’s findings, SWBT raised its residential long distance rates in Texas in February 2001 by 10 to 33 percent, including an increase in basic rates for long-distance service of more than 10 percent.¹⁵⁰ SWBT also increased the “discounted rate” for customers who buy other services from SWBT by 33 percent.¹⁵¹ The rate increase “highlights the fact that SWBT feels like they are in control and they can set the price,” said an analyst with Deutsche Banc Alex. Brown.¹⁵² More recently, SWBT boasted that, with even higher long distance rates in Oklahoma and Kansas, it was achieving market shares for its bundled long distance service comparable to the shares it had initially achieved in Texas with lower entry prices.¹⁵³ SWBT’s long distance price *increase* in Texas and its ability to sustain still higher long distance rates in Oklahoma and Kansas, belie its misleading claim that its entry into long distance has led to long distance price cutting.¹⁵⁴

¹⁴⁹ See also *id.* at 79 (“SB 560 also granted SWBT the ability to competitively bundle its products. An important additional piece in SWBT’s ‘one-stop’ shopping strategy was SWBT’s receiving a favorable recommendation from the Commission on its Section 271 application, leading to FCC approval for SWBT to offer long distance service in Texas in the second half of 2000. SWBT at present has very limited competition in providing bundled services in Texas”).

¹⁵⁰ “SWBT Raises Nonlocal Call Rates: Company Says Prices Better Reflect Costs,” *The Dallas Morning News*, February 2, 2001.

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ TR Daily, SBC Finds Demand Not Dampened By Higher Long Distance Rates, July 25, 2001.

¹⁵⁴ SWBT AR/MO Br. at 148-150. SWBT nowhere mentions in its voluminous pleadings that, since the beginning of 1999, intrastate access charges have been cut by 3.9 cents, and intrastate access rates were slashed an additional two cents per minute after SWBT’s entry into long distance. Thus, in large part, the long distance price-cutting SWBT attributes to its own entry into long distance, simply reflected the flowing through of access rate cuts.

In sum, recent events in Texas demonstrate precisely the danger of premature long distance authorization. The TPUC Report demonstrates that if evidence of a closed local market is ignored on the theory that interLATA authorization will prompt competition, consumers will pay a heavy price in the form of remonopolization and higher prices.

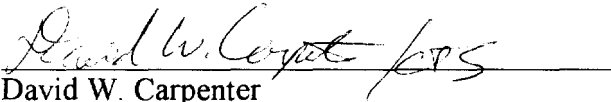
The outcome in Arkansas and Missouri, if SWBT's application were granted, would undoubtedly be far worse than in Texas. For in Texas, numerous competitors have made enormous sunk investments in an effort to make local residential competition a reality. They have learned that residential competition is simply unsustainable without truly cost-based UNE prices. In Arkansas and Missouri, matters are much worse, because the rates are higher and no competitive carrier has sunk significant capital. In these circumstances, SWBT's monopoly over bundled services in Missouri and Arkansas would be invulnerable to competitive challenge from day one. And as in Texas, once SWBT's unique bundle of local and long distance services is available, consumers in Arkansas and Missouri could expect quickly to see the price of that service rise. To avoid remonopolization, the Commission should deny SWBT interLATA authorization until it truly opens its local markets to competition, so that numerous competitors can offer consumers the benefits both of one-stop shopping and of a competitive marketplace.

CONCLUSION

For the reasons stated above, AT&T respectfully submits that SWBT's Joint Application for Arkansas and Missouri should be denied.

Respectfully submitted,

Mark C. Rosenblum
Dina Mack
AT&T CORP.
295 North Maple Avenue
Basking Ridge, NJ 07920
(908) 221-4343


David W. Carpenter
Mark E. Haddad
R. Merinda Wilson
Ronald S. Flagg
David L. Lawson
Richard E. Young
Christopher T. Shenk
SIDLEY AUSTIN BROWN & WOOD
1501 K Street, NW
Washington, D.C. 20005
(202) 736-8000


Attorneys for AT&T Corp.

September 10, 2001

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of September, 2001, I caused true and correct copies of the forgoing Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: September 10, 2001
Washington, D.C.



Peter M. Andros

SERVICE LIST

Magalie R. Salas
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Room TW-B204
Washington, D.C. 20554

Janice Myles
Policy and Program Planning Division
Federal Communications Commission
445 12th Street, SW
Room 5-C327
Washington, D.C. 20554

Qualex International
Portals II
445 12th Street, SW, Room CY-B402
Washington, D.C. 200554

Layla Seirafi
U.S. Department of Justice
Antitrust Division
Telecommunications Task Force
1401 H Street, NW, Suite 8000
Washington, D.C. 20005

Dan Joyce, General Counsel
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

Art Steunkel
Arkansas Public Service Commission
1000 Center Street, P.O. Box 400
Little Rock, AR 72203

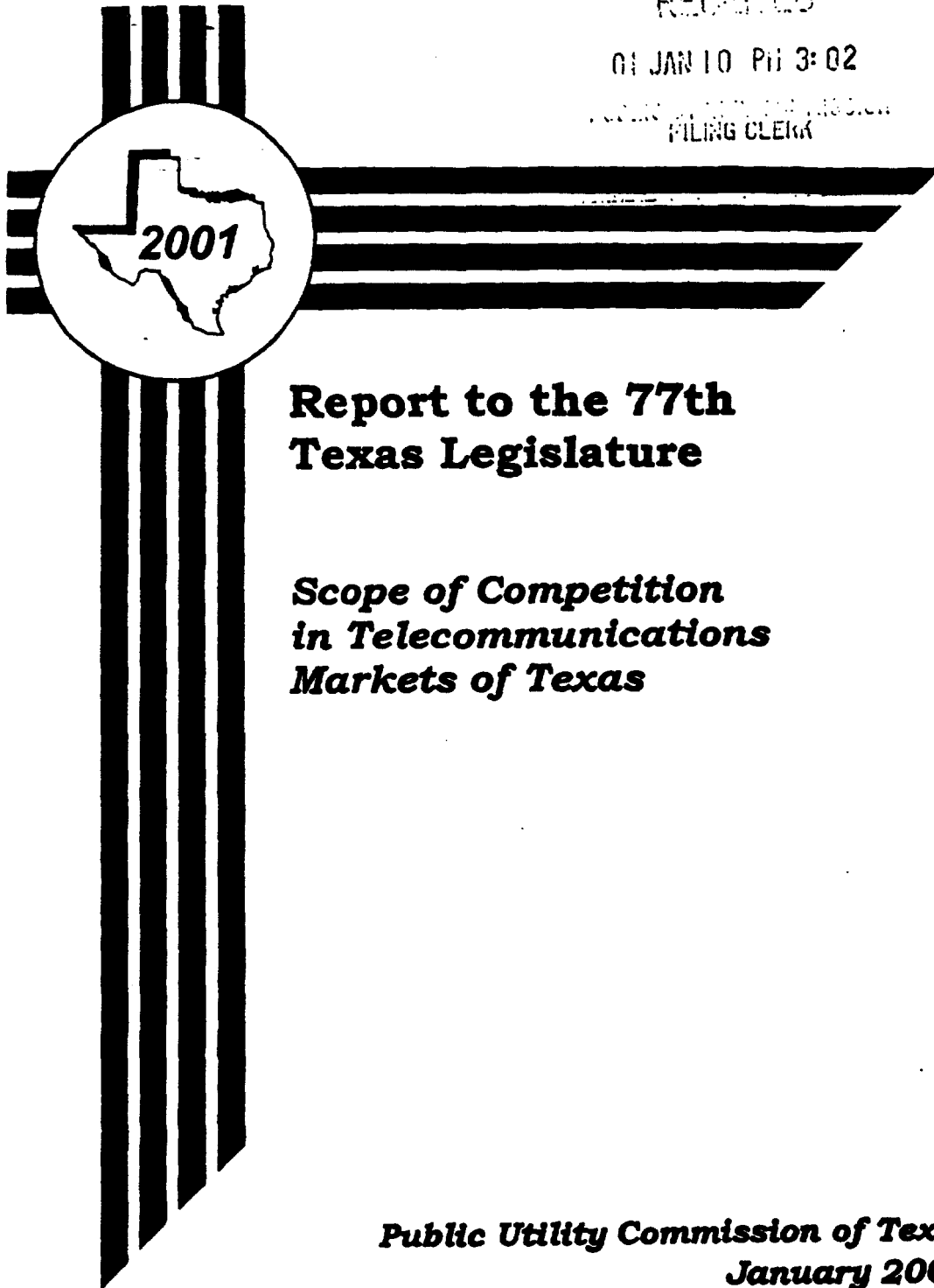
James D. Ellis
Paul M. Mancini
Martin E. Grambow
Kelly M. Murray
Robert J. Gryzmala
John S. DiBene
John M. Lambros
SBC Communications, Inc.
175 E. Houston
San Antonio, TX 78205

Michael K. Kellogg
Geoffrey M. Klineberg
Colin S. Stretch
Kellogg, Huber, Hansen, Todd & Evans
1615 M Street, NW, Suite 400
Washington, DC 20006

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**Report to the 77th
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***Scope of Competition
in Telecommunications
Markets of Texas***

***Public Utility Commission of Texas
January 2001***

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